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SUBJECT: PLANS TO IMPROVE GOI BUDGET EXECUTION

Classified By: Ambassador Zalmay Khalilzad for reasons 1.4 (b) and (d).

11. (C) On October 7 the Ambassador discussed budget execution issues with Deputy Prime Minister Barham Salih and Finance Minister Bayan Jabr at the DPM's initiative. Barham Salih made clear that he is determined to improve not just budget implementation but the overall budgeting process and its relation to the economy. He was equally clear that he was looking for U.S. help in this process, both in terms of political support and technical assistance. Key areas to focus on include the oil ministry and Barham's Supreme Reconstruction Board. It was agreed that the present Baghdad Security Plan-related joint committee would be expanded to include ministries and national-level projects. With respect to the meeting schedule for the International Compact with Iraq, Barham promised to call the Kuwaiti Foreign Minister in the next days to confirm that Kuwait would host the final Prep Group meeting at the beginning of November. He solicited U.S. help in talking to the Saudis about possibly hosting the signing meeting of the Compact at the end of November.

Compact

12. (C) The Ambassador, accompanied by DCM, Econ MinCouns, Treasury Attache and NCT Deputy met with DPM Barham Salih, Finance Minister Jabr and Finance Minister Advisor Aziz at Barham's suggestion to address how to improve budget execution now, and with respect to the '07 budget. Barham began the meeting by noting that UN Iraq envoy Qazi would be talking to UN Deputy SecGen Malloch Brown about the UN approaching the Kuwaitis to host the final Compact Prep Group meeting, which would now be in early November vice October 30 because of the Eid holiday. Barham also later promised to call the Kuwaiti foreign minister himself, and agreed that time was pressing for a decision on that meeting and the signing meeting of the Compact at the end of November. Barham noted that it would be ideal if the Saudis hosted the latter meeting, but if this proved impossible - and he said he would need U.S. help to convince the Saudis to do so - then Rome might be a good option.

Budget Execution

13. (C) Barham said that he intended to inaugurate in the next few days the first of a series of special meetings with Key ministries on budget execution; starting with the Ministry of Oil. (Note: This was a U.S. Mission recommendation. End Note.) Finance Minister Jabr averred that his ministry had not turned down a single request from MinOil for funding, but that the Oil Ministry was seriously under spending its budget despite the urgency of investment needs. Barham added that they were anxious to work with the U.S. to improve the '07 budget and its implementation. Barham was looking for

suggestions on how the GOI could do a better job of managing the economy through the budget process. In response, the DCM presented a number of specific suggestions to solve immediate problems and set the stage for a better '07 budget record. The goal was to get off to a good and early start on spending for '07. He also advocated using the remainder of the '06 budget cycle to work with individual ministries to get as much accomplished still this year as possible. He noted the good results that had been produced by the joint committee on the Baghdad Security Plan (BSP). Working with ministries one at a time with U.S. advisers would be a good way to start, with the goal ultimately being better cross-ministerial coordination on budget execution.

Oil Problems

14. (C) Jabr responded that the place to start was with the Oil Ministry, which had a budget of \$3 billion of which only \$300 million had been spent. He said that he, Planning Minister Baban, and Oil Minister Shahrastani would be getting together in the next days to look at a systemic approach that would get MinOil to adopt more market-based approaches on funds for subsidies and a better system for purchasing equipment as well as capital expenditures.

Practical Issues

15. (C) The DCM urged the DPM to have his staff follow up on ways to expand the BSP contracting group to a broader inter-ministerial level. Barham agreed that it was essential to put an "Iraqi face" on the contracting group and discussed

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his likely choice to coordinate the process in his office. The DCM said the initial focus should be on clearing up Iraq's arrears to restore the country's creditworthiness. Jabr said that a letter of credit (LC) for \$200 million to settle kerosene debt with Turkey had been opened, and Aziz added that \$300 million for the Public Distribution System (PDS) had also just been made available, but that for this amount approval of the Council of Representatives was needed (and was being sought). Jabr said that the PDS still had \$180 million in reserve to use for spot market purchases. He wanted the Trade Ministry to streamline its purchases. The Ambassador replied that in his recent discussion with Trade Minister Sudani, the same theme had been struck, that the PDS needed to develop more of a market approach by using targeted market purchases to encourage more of a trading system in Iraq for basic foodstuffs. Aziz went on to describe various bottlenecks in the system - the gap between what had been allocated to the PDS and what it had spent; the gap between what the Bayji refinery was capable of producing in refined product, and what it actually produced and the fact that MinOil always wanted more money to buy imported product than to solve its own production problems. He gave the example of MinOil's modest request for additional refining equipment for the Doura refinery in Baghdad, when the facility could have been greatly expanded with available funds.

16. (C) Barham expanded on this theme saying that the Economic and Energy Committees he leads could serve as a joint spending and planning committee. He especially wanted to have the committees meet jointly to address the problem in the Oil Ministry. He saw no reason why projects that made economic sense and were politically important like the Erbil pipeline could not get started. Jabr added that he wanted the pipeline project that ran parallel to the old Haditha pipeline started as well, since it would give Iraq another export route and would be a signal to the population in Anbar that they have a stake in Iraq's petroleum resource. The pipeline would be capable of handling 500,000 bbls/day but only take one year to complete.

¶17. (C) On money for Tal Afar, Jabr said he was prepared to release funds but needed a request from the Prime Minister to do so. There was some discussion of whether the letter from Maliki hadn't already been issued, but Jabr confirmed that the funds would be released soon. Aziz added he planned to release the remainder of the \$2 billion allocated for the provinces as well. It was agreed that the U.S. should also work with the provinces to improve their contracting capacities. DCM proposed that the U.S. sponsor a conference to explain Iraqi budgeting processes to ministries and to provincial authorities. Both the DPM and Finance Minister enthusiastically welcomed this idea.

¶18. (C) The DCM presented proposals for keeping funding available for projects started in FY '06 if sufficient progress had been made, obviating the need to re-fund such projects. Jabr agreed saying he had a fix in mind for streamlining the funding of ongoing projects. The U.S. side also pushed the need to make '07 allocations as early as possible so that funding could actually start at the beginning of the year. Jabr agreed, saying his main goal was to start spending money at the beginning of the year so that budget implementation would be greatly sped up. The '07 budget will be presented to the CoR on October 15 as required. The DCM also handed over a paper on the need to get diesel generators in storage in Jordan delivered before the start of the winter rains made transport a problem.

Defense Issues - FMS

¶19. (C) Barham said that the ministry with the most serious budget problems was the MOD. The U.S. side presented a proposal for spending up to \$1.5 billion of the MOD's remaining \$2 billion through the FMS system. Jabr said that he favored such a proposal, but that ministers, such as Shahrastani, were opposed. The Ambassador replied that if the opposition was based on lack of understanding that FMS involves no loss of sovereign Iraqi control of funding choices and didn't tie Iraq exclusively to U.S. suppliers, that these concerns could be addressed. Jabr thought such an information campaign could largely resolve cabinet opposition to use of FMS.

¶10. (C) Barham said that the Planning Ministry was being tasked with reviewing all ongoing projects to come up with ways to improve implementation. While the government needed to speed up spending, it also had to be sure that projects were not inadvertently serving as a way to sustain militias with contracts. He thought the U.S. could serve a useful role as a monitor, and the Ambassador replied that we could pool our resources, to build political acceptance for the

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U.S. to play a role in assisting in contracting, procurement, project oversight, and monitoring. Barham also thought that resources could be provided by contributions through the International Compact with Iraq, especially if Iraq demonstrated in the coming weeks a better commitment to implementation. The Compact could provide needed "interim assistance" in Barham's words to capacity building. He described in more detail the Supreme Reconstruction Council from the days of the monarchy, and how it could be structured to be headed by the Prime Minister, with key cabinet ministers but also independent experts. The goal was to come up with major multi-year projects such as railways, highways, housing and upgrading the power system. Barham said he had found a plan from the '80's for the railway system that was still valid and could be put into implementation quickly. Jabr added that he was seeking to find ways in the '07 budget for multi-year funding, with projects funded for up to three years. He returned to the idea for a conference on how to work in the budgeting process and reiterated his offer to work with U.S. experts to structure such an event.

¶11. (C) Barham concluded the budget implementation discussion by saying that the '07 budget would effectively decide the success or failure of Iraq's economic future. He was counting on U.S. help both in how to structure the budget and fundamentally improve implementation. He wanted to be able to tell Iraqis that if the budget is implemented well, spending can rise from \$26 billion to \$40 billion which would be a good start on addressing Iraq's real needs. He wanted to include bank reform and reform of the LC system into the budget process as well. The Ambassador welcomed this bold approach, but noted that Iraq needed to address the inflation problem at the same time if increased spending wasn't going to lead to even more serious inflationary pressures. Both Jabr and Barham acknowledged that Central Bank Chairman Shabibi was not very flexible on dinar appreciation, but they would continue their efforts to get him to be more supportive, within the framework of the Central Bank's independence. Jabr added, however, that he did not think the inflation figures really captured overall price rises in Iraq. The shortages and security situation created many statistical anomalies that tended to overstate inflation, in his view. Nevertheless, there was a need to address the problem. He attached great importance to getting the regulation for the recently-passed Fuel Import Liberalization Law (FILL) adopted quickly and proposed a conference with the private sector to develop market-oriented regulations when he and Shahrastani are in Amman to meet with the IMF at the beginning of November. He suggested November 6 as a good date for such a conference.

¶12. (C) Comment. Both Jabr and Barham Salih came across as genuinely committed to address and expand the budget implementation issue. Building off the success of the Ministerial Executive Steering Committee in assisting the Baghdad Security Plan in removing bottlenecks is a step in the right direction in dealing with ministries. The idea of a conference or series of conferences for Iraqi and provincial officials will require quick turnaround to seize the moment. But if the DPM and Finance Minister can really energize the government to begin getting money spent and projects started, this could be an important milestone in the recovery of the Iraqi economy and the credibility of the Maliki government. End comment.
KHALILZAD